Capital Standards

FIL-3-95
January 5, 1995

TO: CHIEF EXECUTIVE OFFICER

SUBJECT: *Final Rule on Regulatory Capital Treatment of Unrealized Holding Gains and Losses Under FASB 115*

The FDIC Board of Directors has approved a final rule that clarifies the regulatory capital treatment for net unrealized holding gains and losses on "available-for-sale" securities. A copy of the final rule is attached.

FASB 115 -- Statement No. 115 of the Financial Accounting Standards Board ("Accounting for Certain Investments in Debt and Equity Securities") -- requires banks to recognize, as a separate component of stockholders' equity, the amount of net unrealized holding gains and losses on securities that are deemed to be available-for-sale. Securities are generally carried in the available-for-sale category when a bank does not have the positive intent and ability to hold the securities to maturity, yet does not intend to trade them actively as part of a trading account.

Under the instructions for preparing the Consolidated Reports of Condition and Income (Call Reports), banks are required to follow FASB 115 for regulatory reporting purposes. However, for regulatory capital purposes, the FDIC has decided not to proceed with its earlier proposal (see FIL-1-94, dated January 4, 1994), which would have required unrealized gains and losses on all available-for-sale securities (debt as well as equity) to be included in determining Tier 1 capital. This proposed treatment of unrealized gains and losses could have resulted in greater volatility in bank regulatory capital levels. Instead, the FDIC has adopted only technical wording changes to conform the language in its leverage and risk-based capital rules to the terminology used in FASB 115.

Under this final rule, net unrealized holding losses on available-for-sale equity securities (but not debt securities) with readily determinable fair values will be included (i.e., deducted) when calculating Tier 1 capital. All other unrealized holding gains and losses on available-for-sale securities are excluded from the definition of Tier 1 capital. The extent of any unrealized appreciation or depreciation on securities, however, will continue to be one of the factors FDIC examiners consider in their overall qualitative assessment of an institution's capital adequacy.

This regulatory capital treatment is consistent with final rules that are being adopted by the other federal banking agencies for the depository institutions they supervise. It is also consistent with the interim regulatory capital guidance issued jointly by the FDIC, the Federal Reserve Board and the Office of the Comptroller of the Currency on December 21, 1993 (see FIL-91-93), and with the treatment recommended to the federal banking agencies by the Federal Financial Institutions Examination Council's Task Force on Supervision on November 10, 1994.

The FDIC's final rule will become effective on January 27, 1995. See the enclosed Federal Register notice for a detailed explanation of this rule. For more information, contact Examination Specialist Stephen G. Pfeifer or Section Chief Robert F. Storch, both in the Division of Supervision's Accounting Section (202-898-8914).

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Director

Attachment: Federal Register

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